

D.T.E. 04-80

October 25, 2004

Petition of Bay State Gas Company, pursuant to G.L. c. 164, § 14, for authorization and approval to issue long-term debt in the principal amount of up to \$120 million, and for exemption from the competitive bidding and advertising requirements of G.L. c. 164, § 15.

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FOR: BAY STATE GAS COMPANY  
Petitioner

## I. INTRODUCTION

On August 19, 2004, Bay State Gas Company (“Bay State” or “Company”) filed with the Department of Telecommunications and Energy (“Department”) a petition, pursuant to G.L. c. 164, § 14, requesting approval and authorization to issue and sell long-term unsecured promissory notes in an aggregate amount up to \$120 million to its affiliate, NiSource Finance Corporation. The Company also seeks an exemption from the competitive bidding and advertising requirements of G.L. c. 164, § 15.

Pursuant to notice duly issued, public and evidentiary hearings were held at the Department’s offices in Boston on September 28, 2004. No petitions for leave to intervene were filed. At the evidentiary hearing, the Company presented the testimony of one witness in support of its petition: Vincent Rea, assistant treasurer at Bay State and at NiSource Corporate Services Company, and director of treasury and corporate finance at NiSource, Inc.<sup>1</sup> The evidentiary record consists of 30 exhibits and two responses to Department record requests.

## II. DESCRIPTION OF THE PROPOSED FINANCING

### A. Long-Term Debt

Bay State proposes to issue unsecured long-term notes, in an aggregate amount not to exceed \$120 million at face value, to its affiliate NiSource Finance Corporation (“NiSource Finance”) (Exh. BSG-10, at 1). The Company proposes to issue the notes over an 18-month period, with up to \$90 million to be issued by December 31, 2004 (Exhs. BSG-1, at 3,

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<sup>1</sup> NiSource, Inc., is Bay State’s parent company; NiSource Corporate Services is the service company affiliate and NiSource Finance Corporation is the financing entity for NiSource Inc. (Tr. at 10, 14-15).

BSG-10, at 2). The notes may be issued for terms of ten, 15 or 20 years (Exhs. BSG-1, at 3, BSG-10, at 2). The interest rate for each note will be market-based and determined by the corresponding applicable Treasury yield in effect on the date of issuance, plus a credit spread associated with the Company's financial risk profile as reported by Reuters Corporate Spreads for Utilities<sup>2</sup> (Exhs. BSG-1, at 5, DTE 1-6, DTE 1-7).<sup>3</sup>

According to Bay State, up to \$110 million of the proceeds of the proposed financing will be used to pay down short-term borrowings from the NiSource Money Pool and maturing long-term debt, and fund anticipated capital requirements, and the remainder will be used to refinance a \$10 million long-term note maturing in June 2005 (Exhs. BSG-1, at 3-4, DTE 1-1, DTE 1-2). Of the \$90 million in notes to be issued before December 31, 2004, \$37 million will be used to refinance maturing long-term debt and take advantage of early redemption features for outstanding long-term debt, and \$53 million will be used to refinance short-term borrowings (Exh. BSG-1, at 4). Thus, the net effect of the proposed financing would be to increase Bay State's long-term debt by no more than \$110 million (id. at 4, 6-7).

B. Exemption from G.L. c. 164, § 15

The Company requests that the Department grant an exemption from the advertising and competitive bidding requirements of G.L. c. 164, § 15 (Exh. BSG-10, at 3-4). The

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<sup>2</sup> The Reuters Corporate Spreads for Utilities is a compilation of spreads at various ratings for bonds with maturities ranging from one year to 30 years, as taken from a composite of investment banks (Tr. at 15-16).

<sup>3</sup> For example, based on the Company's present BBB/Baa2 credit rating, and using Treasury yields and credit spreads in effect as of September 10, 2004, an eight-year note would carry an interest rate of 4.923 percent (Exh. DTE 1-7).

Company indicates that the interest rate associated with the notes is market-based, and that the Company would be able to avoid underwriting and transaction costs estimated to be between \$945,000 and \$1,080,000 (Exh. BSG-1, at 5-6; Tr. at 18-19).<sup>4</sup> Moreover, Bay State contends that the proposed financing will allow the Company to take maximum advantage of interest rates and market conditions, including structuring maturities to avoid excessive refinancing and interest rate risks in any particular year (Exh. BSG-1, at 6). These refinancing risks include the requirement by lenders that the Company's debt instruments include "make-whole" provisions that could hinder Bay State's ability to refinance the debt in the future (Tr. at 19-20).

### III. CAPITAL STRUCTURE

As of June 30, 2004, the Company reported a gross utility plant in service of \$747,111,849 (Exh. BSG-7).<sup>5</sup> After removing \$284,386,162 in accumulated depreciation and adding \$29,625,128 in gas inventories, the Company reported a net utility plant of \$492,350,825 (id.).

As of June 30, 2004, the Company reported a total capitalization, excluding retained earnings, of \$255,265,658 (Exh. BSG-7). This balance consisted of \$108,500,000 in

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<sup>4</sup> By contrast, the Company estimates that the transaction costs associated with the proposed financing will not exceed \$2,500 (Exh. DTE 1-4).

<sup>5</sup> The Company's plant and capitalization balances exclude all of the effects of the acquisition of Bay State by NiSource, Inc., including the acquisition premium and its associated amortization (Exh. BSG-7).

long-term debt, \$100 in common stock, and \$146,765,658 in premium on common stock (Exhs. BSG-7, DTE 1-14).

In order to demonstrate that it would meet the net plant test requirements of G.L. c. 164, § 16, after the proposed issuance, Bay State provided projected plant and capitalization data for the year ending December 31, 2004, incorporating the proposed \$90 million issuance to take place by that date (Exhs. BSG-6A; BSG-7A; BSG-8; BSG-8A). The Company projected that it would have a net utility plant (gross plant less accumulated depreciation plus gas inventories) of \$505,791,933 by December 31, 2004 (Exh. BSG-7A). By that same date, the Company projects a total capitalization of \$401,293,587, consisting of \$198,500,000 in long-term debt; \$100 in common stock; \$146,765,558 in paid-in capital; and \$56,027,929 in retained earnings (Exh. BSG-8A). The Company's total anticipated capitalization, excluding retained earnings, amounted to \$365,265,658 (Exh. BSG-7A). Therefore, the Company concluded that it would have \$140,526,275 more in plant than securities outstanding, thereby meeting the requirements of the net plant test (*id.*).

#### IV. STANDARD OF REVIEW

##### A. Long-Term Debt and Preferred Securities Issuance

In order for the Department to approve the issuance of stocks, bonds, coupon notes, or other types of long-term indebtedness<sup>6</sup> by an electric or gas company, the Department must determine that the proposed issuance meets two tests. First, the Department must assess

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<sup>6</sup> Long-term refers to periods of more than one year after the date of issuance. G.L. c. 164, § 14.

whether the proposed issuance is reasonably necessary to accomplish some legitimate purpose in meeting a company's service obligations, pursuant to G.L. c. 164, § 14. Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 395 Mass. 836, 842 (1985) ("Fitchburg II"), citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities, 394 Mass. 671, 678 (1985) ("Fitchburg I"). Second, the Department must determine whether the Company has met the net plant test.<sup>7</sup> Colonial Gas Company, D.P.U. 84-96 (1984).

The Supreme Judicial Court has found that, for the purposes of G.L. c. 164, § 14, "reasonably necessary" means "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency." Fitchburg II at 836, citing Lowell Gas Light Company v. Department of Public Utilities, 319 Mass. 46, 52 (1946) ("Lowell Gas"). In cases where no issue has been raised about the reasonableness of management decisions regarding the requested financing, the Department limits its G.L. c. 164, § 14 review to a determination of reasonableness of the Company's proposed use of the proceeds of a stock issuance. Canal Electric Company, et al., D.P.U. 84-152, at 20 (1984); see, e.g., Colonial Gas Company, D.P.U. 90-50, at 6 (1990). The Fitchburg I and II and Lowell Gas cases also

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<sup>7</sup> The net plant test is derived from G.L. c. 164, § 16. When the Department approves an issue of new stock, bonds, or other securities by a gas or electric company, if it determines that the fair structural value of the plant and of the land and the fair value of the nuclear fuel, gas inventories, or fossil fuel inventories owned by such company is less than its outstanding stock and debt, it may prescribe such conditions and requirements as it deems best adapted to make good within a reasonable time the impairment of the capital. See G.L. c. 164, § 16.

established that the burden of proving that an issuance is reasonably necessary rests with the company proposing the issuance, and that the Department's authority to review a proposed issuance "is not limited to a 'perfunctory review.'" Fitchburg I at 678; Fitchburg II at 841, citing Lowell Gas at 52.

Regarding the net plant test, a company is required to present evidence that its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total capitalization (the sum of its long-term debt and its preferred and common stock outstanding) and will continue to do so following the proposed issuance. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). Where issues concerning the prudence of the Company's capital financing have not been raised or adjudicated in a proceeding, the Department's decision in such a case does not represent a determination that any specific project is economically beneficial to a company or to its customers. In such circumstances, the Department's determination in its Order may not in any way be construed as ruling on the appropriate ratemaking treatment to be accorded any costs associated with the proposed financing. See, e.g., Boston Gas Company, D.P.U. 95-66, at 7 (1995).

B. Exemption from G.L. c. 164, § 15

Pursuant to G.L. c. 164, § 15, an electric or gas company offering long-term bonds or notes in excess of \$1,000,000 in face amount payable at periods of more than five years after the date thereof must invite purchase proposals through newspaper advertisements. The Department may grant an exemption from this advertising requirement if the Department finds that an exemption is in the public interest. G.L. c. 164, § 15. The Department has found it in

the public interest to grant an exemption from the advertising requirement where there has been a measure of competition in private placement. See, e.g., Berkshire Gas Company, D.P.U. 89-12, at 11 (1989); Eastern Edison Company, D.P.U. 88-127, at 11-12 (1988); Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988). The Department also has found that it is in the public interest to grant a company an exemption from the advertising requirement when a measure of flexibility is necessary in order for a company to enter the bond market in a timely manner. See, e.g., Western Massachusetts Electric Company, D.P.U. 88-32, at 5 (1988). However, G.L. c. 164, § 15 requires advertising as the general rule, and waiver cannot be automatic, but must be justified whenever requested. Bay State Gas Company, D.T.E. 02-73, at 14.

## V. ANALYSIS AND FINDINGS

### A. Issuance of Long-Term Debt

#### 1. “Reasonably Necessary” Standard

The Company has stated that its proposal to issue up to \$120,000,000 principal amount of long-term debt is for the purpose of selling the securities and using the proceeds to retire outstanding long-term debt and equity securities; to refinance short-term and long-term debt; for the payment of capital expenditures for additions to property, plant, and equipment; and for general working capital purposes (Exh. BSG-1, at 3-4, BSG-10, at 1). The Department has found that issuing debt for the purposes of paying down short-term debt and refinancing long-term debt is a “legitimate utility purpose” as contemplated by G.L. c. 164, § 14. Blackstone Gas Company, D.T.E. 03-65, at 4 (2003); Western Massachusetts Electric



Company, D.T.E. 02-49, at 10 (2003); New England Power Company, D.P.U. 95-101, at 11 (1995). Likewise, the Department has found that redeeming existing securities and funding utility operations is a customary purpose of securities issuances. Southern Union Company, D.T.E. 03-3, at 18 (2003); Berkshire Gas Company, D.P.U. 96-64, at 8-9 (1996).

Accordingly, the Department finds that Bay State's proposed issuance of long-term debt securities in an aggregate amount up to \$120,000,000 is reasonably necessary to accomplish a legitimate purpose in meeting the Company's service obligations in accordance with G.L. c. 164, § 14.

## 2. Net Plant Test

In regard to the net plant test, the Department requires companies to demonstrate that their net utility plant equals or exceeds their total capitalization, thereby supporting the additional amount of financing, pursuant to G.L. c. 164 § 16. Colonial Gas Company, D.P.U. 84-96, at 5 (1984). The purpose of the net plant test is both to protect ratepayers from excessive rates associated with overcapitalization and to assure the creditors of a utility that the company has sufficient tangible assets to cover its liabilities. Boston Gas Company, D.T.E. 03-40, at 321 (2003); Colonial Gas Company, D.P.U. 1247-A at 7 (1982); Report of the Department of Public Utilities Relative to the Capitalization of Gas and Electric Companies, Senate Document No. 315, at 8-15 (January 1922). Under the net plant test, a company must present evidence showing that its net utility plant (utility plant less accumulated depreciation) is equal to or greater than its total capitalization (the sum of debt, preferred

stock, and common stock outstanding).<sup>8</sup> Southern Union Company, D.T.E. 04-36, at 9 (2004); Colonial Gas Company, D.P.U. 84-96, at 5 (1984).

As noted above, Bay State's net utility plant plus gas inventories as of June 30, 2004 was \$492,350,825 (Exh. BSG-7). The Company reported a total long-term debt, common stock, and paid-in capital balance on that same date of \$255,265,658 (id.). Of this amount, \$146,765,658 represents additional paid-in capital that includes \$870,173 in cumulative capital contributions from NiSource, Inc. that are associated with an intercompany income tax allocation agreement between NiSource, Inc. and its subsidiaries (Exh. DTE 1-14; RR-DTE-1). These intercompany tax benefits are a form of capital infusion by NiSource, Inc. to Bay State, which do not constitute a financial proceeding requiring further Department approval under G.L. c. 164, § 14. Fitchburg Gas and Electric Light Company, D.T.E. 03-72, at 9 (2003); see also Massachusetts-American Water Company, D.P.U. 95-41, at 9 (1995). The Department considers these types of transient capital contributions from a parent company to be distinct from the operating company's common stock as applied in G.L. c. 164, § 16. Therefore, for purposes of determining the Company's ability to meet the requirements of the net plant test, the Department will remove \$870,173 from Bay State's capitalization. This adjustment produces a revised premium on common stock of \$145,895,485, and a revised capitalization of \$254,395,485. Consequently, the Company had an excess of net utility plant over outstanding capital of \$237,955,340 as of June 30, 2004.

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<sup>8</sup> For purposes of the net plant test, the premium on common stock is treated as common stock. Southern Union Company, D.T.E. 04-36, at 9 n.5 (2004); Berkshire Gas Company, D.T.E. 03-89, at 23 (2004).

In addition, Bay State has produced satisfactory evidence in the form of financial and plant data that sufficient plant will remain available on December 31, 2004 to provide for both the issuance of up to \$90 million in notes by that date, and \$120 million in notes over the 18-month period of the proposed financing (Exhs. BSG-7A, BSG-8, BSG-8A). Accordingly, the Department finds that the Company's issuance of up to \$120,000,000 in long-term securities meets the net plant test as provided in G.L. c. 164, § 16.

Issues concerning the prudence of the proposed financing have not been raised in this proceeding, and the Department's decision in this case does not represent a determination that any project is economically beneficial to the Company or its customers. The Department's determination in this Order is not in any way to be construed as a ruling relative to the appropriate ratemaking treatment to be accorded any costs, including interest expense, associated with the proposed financing.

B. Exemptions from G.L. c. 164, § 15

Bay State contends that an exemption from the competitive bidding provisions of G.L. c. 164, § 15 is appropriate because the notes will bear an interest rate representative of current market conditions (Exh. BSG-10, at 3-4). The Company states that the proposed financing through NiSource Finance will avoid underwriting and transaction costs estimated between \$945,000 and \$1,080,000 (Exh. BSG-1, at 5-6; Tr. at 18-19). Moreover, Bay State contends that the proposed financing will allow the Company to take maximum advantage of interest rates and market conditions, including structuring maturities to avoid excessive refinancing and interest rate risks in any particular year (Exh. BSG-1 at 6).

The interest rate associated with the notes Bay State proposes to issue to NiSource Finance will be at market-based rates at the time the notes are issued (Exhs. BSG-1, at 5, BSG-9; Tr. at 18). Additionally, a public placement of the proposed issuance would be considerably more expensive because of the higher fixed cost of a public offering, including underwriting expenses and the potential make-whole provisions (Exhs. BSG 5-6, DTE 1-4, DTE 1-8; Tr. at 18-20). In light of the foregoing considerations, the Department finds that the Company has demonstrated that the benefits of a competitive solicitation process are enjoyed by its ratepayers through the use of market-based interest rates, and that the additional cost and time associated with a competitive solicitation process would not produce a more favorable result to ratepayers. Western Massachusetts Electric Company, D.T.E. 02-49, at 12 (2003). The Department further finds that, in this case, it is appropriate to allow the Company the flexibility offered by a private placement through NiSource Finance in order to facilitate the Company's access to the capital markets. Therefore, based on the foregoing analysis, the Department finds that it is in the public interest to exempt Bay State from the advertising and competitive bid requirements of G.L. c. 164, § 15.

VI. ORDER

Accordingly, after due notice, hearing, and consideration, the Department

VOTES: That the issuance and sale by Bay State Gas Company of long-term unsecured promissory notes in an aggregate amount up to \$120 million to its affiliate NiSource Finance Corporation is reasonably necessary for the purposes for which such issuance and sale has been authorized, and

VOTES: That it is in the public interest that Bay State Gas Company's issuance and sale of long-term unsecured promissory notes in an aggregate amount up to \$120 million to its affiliate NiSource Finance Corporation be exempt from the requirements of G.L. c. 164, § 15; and it is

ORDERED: That the issuance and sale by Bay State Gas Company of long-term unsecured promissory notes in an aggregate amount up to \$120 million to its affiliate NiSource Finance Corporation is reasonably necessary for the purposes for which such issuance and sale has been authorized, and it is

FURTHER ORDERED: That Bay State Gas Company's issuance and sale of long-term unsecured promissory notes in an aggregate amount up to \$120 million to its affiliate NiSource Finance Corporation, without complying with the competitive bidding provisions of G.L. c. 164, § 15, is in the public interest, and that such issuance and sale shall be exempt from the provisions of G.L. c. 164, § 15; and it is

FURTHER ORDERED: That the net proceeds from such sale of unsecured promissory notes shall be used for the purposes set forth herein; and it is

FURTHER ORDERED: That Bay State Gas Company provide the Department with a copy of the final version of the note(s); and it is

FURTHER ORDERED: That Bay State Gas Company comply with all other directives contained in this Order; and it is

FURTHER ORDERED: That the Secretary of the Department shall within three days of the issuance of this Order cause a certified copy of it to be filed with the Secretary of the Commonwealth.

By Order of the Department,

\_\_\_\_\_/s/\_\_\_\_\_  
Paul G. Afonso, Chairman

\_\_\_\_\_/s/\_\_\_\_\_  
James Connelly, Commissioner

\_\_\_\_\_/s/\_\_\_\_\_  
W. Robert Keating, Commissioner

\_\_\_\_\_/s/\_\_\_\_\_  
Eugene J. Sullivan, Jr., Commissioner

\_\_\_\_\_/s/\_\_\_\_\_  
Deirdre K. Manning, Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within 20 days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of 20 days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971.